to be expected from the free flow of credit from one part of the country to the other to meet demands for commercial, industrial or agricultural purposes, are supplied by the inter-bank rediscounting feature of the Federal Reserve System, but that the aim of having the problems of each district entrusted to directors living within the district and to officers closely familiar with these problems, with full discretion and power to act within their own districts, has also been attained. The Federal Reserve System may be said to give the advantages of the mobilization and centralization of banking reserves while preserving the typically American freedom from highly centralized control.

The Evolution and Practical Operation of the Gold Settlement Fund

By GEORGE J. SEAY
Governor of the Federal Reserve Bank of Richmond

IT is difficult to realize that only seven years have elapsed since the establishment of the Federal Reserve Banks. During that period, matters of such tremendous import to the world have happened and developments in banking and finance have been so revolutionary in their nature and size that we have a full understanding of the feelings of the small boy of seven who declared that, although only seven, judging by the experience he had had, he was 'most a hundred. Since 1914, the resources of the banks of the United States have grown from 27 billions of dollars to 53 billions, and bank clearings have grown from 155 billions to 451 billions. In measuring the national debt, the income of the Treasury and taxation, the unit is no longer a million but a billion.

All the momentous and tragic experiences of life leave an impression upon the mind of having occupied a prolonged period. Therefore, it seems that the Federal Reserve System has been operating for a period much longer than that measured by seven calendar years. As a matter of fact, it has, beyond doubt, developed in those seven years at a pace far more rapid than could have been expected in normal times. The country seems accustomed and seasoned to the operations of the Federal Reserve System, but, it becomes apparent from time to time that many people and even many banks have not a full appreciation of the accomplishments of the System or a full understanding of the fact that financial transactions of the magnitude developed within these seven years were rendered possible only by the operation of the System.

The country banker, when he sends his checks and collection items to his city correspondent, may think that thereby he is creating exchange. This is but the first and the lowest step in the creation of exchange. The processes involved in the collection and final settlement of such items are numerous and they constitute the fabric of exchange. The Federal Reserve System has developed the most comprehensive and most effective system of exchange known to the banking world.

The Federal Reserve Banks act as clearing houses for their members, and the various transactions engaged in by these banks create balances between

them and their members and between each other. The Federal Reserve Board has set up machinery which operates as a clearing house between Federal Reserve Banks, and the Gold Settlement Fund is the heart of the System.

Therefore, an account of the evolution and the practical operation of the Gold Settlement Fund, through which final payment is made for that vast volume of credit instruments circulating throughout the country, must contribute to a better understanding of the System as a whole.

EARLY NEED OF INTER-BANK SETTLEMENT MACHINERY

Under the terms of the Federal Reserve Act, the Federal Reserve Board, in Section 16, was authorized at its discretion to exercise the functions of a clearing house for Federal Reserve Banks. It is not to be supposed that there dwelt in the minds of the framers of this provision of the Act any well-defined conception of the manner in which this function would be exercised and least of all of the nature and magnitude of the settlements which this "clearing house" would be called upon to make within such a short period of time.

During the early days, after the organization of the Federal Reserve Banks in November, 1914, they were occupied chiefly by the receipt of payments of subscriptions to capital stock and with the receipt from member banks of deposits setting up the reserve required by the Act. Payments on account of subscriptions to capital stock were required to be made in gold or gold certificates. Reserve deposits were required to be made either in gold or lawful money, except that Federal Reserve Banks were authorized to receive as reserve not exceeding one-half of each installment payment in eligible paper, as described in Section 14. That is to say, member banks were permitted to rediscount at that time with their Federal Reserve Bank to this extent in establishing reserves.

Under date of November 25, 1914, a circular was issued by the Federal Reserve Bank of Richmond, advising its members that the bank was ready to commence rediscounting in the regular course of business and in a position to furnish Federal Reserve notes for the proceeds of rediscounts. The member banks had previously been advised that collections and clearings could not be undertaken at the beginning and that, therefore, active accounts of member banks could not be established until further notice. They were advised, however, that after initial payments of reserve had been made, checks drawn on any member bank in the cities of Richmond, Washington and Baltimore, all within the district, would be received for the credit of the members. The member banks were cautioned, however, that while the Richmond bank was accepting checks on banks in the reserve cities of the Fifth District "it is not intended at this stage that the Reserve Bank shall be used merely to transfer balances in one place in order to make them available in another," and further "members are expected to use their present clearing connections for making collections until greater preparation has been made for clearing."

Notwithstanding the restricted nature of the business conducted at that time, balances in excess of the required reserve were created, and checks against these balances found their way into other districts. No machinery had been set up to effect settlements between Federal Reserve Banks, but it was the understanding that any Federal Reserve Bank would have the

right to call upon any other for remittances in gold to effect settlement of balances between the two.

At that time of the year (December) the flow of funds was towards New York, and, as a result of the practice of receiving from member banks for credit checks on their balances in the reserve cities of this district and then permitting the banks to check on such balances—which checks were usually sent to New York in order to create exchange—the Federal Reserve Bank of Richmond became in debt to the Federal Reserve Bank of New York for several millions of dollars. To place restraint upon this practice it became necessary to advise member banks that such checks deposited with the Federal Reserve Bank for the purpose of creating exchange would be subject to a charge for collection, in accordance with Section 16 of the Act. On January 18, 1915, in sending out notification of the second installment due on capital stock subscriptions, members were advised that payments could be made by means of checks on national banks in New York City instead of in gold. This was done for the purpose of reducing the debt of the Richmond Bank to the New York Bank, thus, to that extent, avoiding settlement with the New York Bank in gold.

It will be apparent that very early in the operation of the System the necessity for providing the machinery for making settlement between Federal Reserve Banks was a pressing one, and during that time careful study was being given to the question, both by the Federal Reserve Board and the officers of the Federal Reserve Banks.

ESTABLISHMENT OF THE GOLD SETTLEMENT FUND

Prior to the organization of Federal Reserve Banks, a report was made to the Reserve Bank Organization Committee, by those whose services were engaged for the purpose, which contained many practical suggestions as to the organization and operation of Federal Reserve Banks. Among these was a suggestion for a "Federal Reserve Clearing House," which involved the deposit of a certain sum of gold by each Federal Reserve Bank with the Federal Reserve Board or with any Federal Reserve Bank designated by the Board to act as a clearing agent and settle balances between Federal Reserve Banks by means of book entries made by a settling agent or by certificates issued by the settling agent.

At the first conference of the governors of the banks, held with the Board in Washington, December 10, 11 and 12, 1914, a special committee was appointed to study the subject and report to the next conference. At the second conference held in Washington, January 20–23, 1915, the report of the committee was received, discussed by the conference, and, with several amendments, was submitted to the Federal Reserve Board. The plan submitted to the Board by this conference was substantially that outlined in the report of the preliminary committee on organization, though many details were submitted by the conference. The Board took the matter under consideration and announced in April, 1915, that the plan of settlement between Federal Reserve Banks had been completed and would become effective about the middle of May, 1915.

In the meantime, all the Federal Reserve Banks had been maintaining accounts with one another, which accounts, of course, were affected by all interdistrict transactions.

Under date of May 8, 1915, the Federal Reserve Board issued its *Bulletin* No. 13, Series of 1915, out-

lining the plan of clearing between Federal Reserve Banks. The plan was designed to effect settlements of all balances then outstanding and thereafter to settle accounts between Federal Reserve Banks weekly. The following is a brief statement of the principal feature of the plan: Each Federal Reserve Bank was required to forward to the Treasury at Washington or the nearest subtreasury for credit in the account of the Gold Settlement Fund one million dollars in gold, gold certificates or gold order certificates, in addition to an amount at least equal to its net indebtedness to all Federal Reserve Banks.

The Treasury Department undertook to advise the Federal Reserve Banks of the receipt of the funds and undertook further to deliver to the Federal Reserve Board gold certificates payable to the order of the Federal Reserve Board in denominations of ten thousand dollars, covering the sum so deposited. Each Federal Reserve Bank was required to make such payment into the Gold Fund from time to time as might be necessary to maintain the balance to its credit in the Fund at one million dollars. Federal Reserve Banks having balances in excess of one million dollars, as a result of clearing operations, were allowed to withdraw the excess at will, payment to be made by shipment of gold order certificates to the said bank by the Board, or payment through the nearest subtreasury.

The Board kept a set of books in which there was an account for each Federal Reserve Bank, showing at all times the amount of gold held for each bank. The gold order certificates representing the gold held by the Treasury were kept in a safe in the Treasury vaults set apart for the exclusive use of the Board, to be opened only in the presence of two persons designated by the Secretary and two designated by the Board. The balance of each Federal Reserve Bank in the Gold Fund was permitted to be counted as a part of the gold reserve of the bank. Each Federal Reserve Bank was required to keep two accounts with every other Federal Reserve Bank, one showing the total amount due to the other Federal Reserve Bank and the other, the amount due from the other Federal Reserve Bank.

The first settlement, being historic, will be described. It was made in the following manner. At the close of business, Wednesday, May 19, 1915, each Federal Reserve Bank advised the Federal Reserve Board by wire the amount in even thousands due by it to each other Federal Reserve Bank as of that day. On Thursday, May 20, the settling agent appointed by the Board telegraphed each Federal Reserve Bank the amount of credits to its settling account, giving the name of each bank from which such credits were received, also the net debit or credit balance in the settlement. After the receipt of these advices, but not later than May 24, each Federal Reserve Bank was required to put into the Gold Fund by shipment or transfers of gold or gold certificates of the United States, directly or through the nearest subtreasury, an amount sufficient to cover its debit balance, if any, and to establish a credit balance of at least one million dollars. The totals so remitted at that time were $18,450,000. The Federal Reserve Banks made appropriate entries in their accounts based upon the report of the settling agent. Thus the Gold Settlement Fund was launched. Thereafter, settlements were made weekly, on Thursday, upon the basis of figures telegraphed by each Federal Reserve Bank at the close of business Wednesday.

The Treasury Department had not only agreed to receive remittances in gold and to issue ten thousand dollar gold order certificates to the Federal Reserve Board, but had also agreed to allow the use of the subtreasuries in connection with remittances and withdrawals from the Gold Fund by Federal Reserve Banks. It was understood and agreed, however, that if the receipt of such remittances or the making of such payments at any time involved the actual shipment of gold from the Treasury at Washington to a subtreasury, or vice versa, the expense of such shipments should be borne by the Federal Reserve Banks.

COMMENCEMENT OF AN INTRA-DISTRICT CLEARING PLAN BY FEDERAL RESERVE BANKS

It will be understood that the balances of member banks with their Federal Reserve Banks were affected chiefly by two operations: first, by discount operations, and, second, by the collection of checks through the Federal Reserve Bank. Up to this time, as before described, the collection of checks by a Federal Reserve Bank for its members, even within its own district, had been very limited. In June, 1915, most, if not all, of the Federal Reserve Banks put into operation a voluntary plan of intra-district collections. According to this plan, a Federal Reserve Bank invited all of its members to join the collection plan, under which each member that joined the plan could send to the Federal Reserve Bank checks upon every other member that had joined the plan but upon no other members and upon no member outside of its own district. The Federal Reserve Bank would give the sending member bank immediate credit for such checks in its reserve account. On the other hand, each member bank joining the plan had agreed that upon the day of receipt the Federal Reserve Bank could charge its reserve account with the total amount of checks drawn upon it.

While the operations of this plan did not primarily involve relations between Federal Reserve Banks, such relations were indirectly involved. Clearings under the plan depleted the reserve accounts of some members and resulted in excess balances in the reserve accounts of others. The member bank whose reserve accounts had been depleted had to remit in gold or lawful money or in some form of exchange acceptable to the Reserve Bank. Other banks whose clearings resulted in excess balances had the right to check against such balances and checks on one Federal Reserve Bank were received for credit by other Federal Reserve Banks. These transactions, in so far as they affected the accounts between Federal Reserve Banks, tended to increase the volume of the weekly settlements through the Gold Settlement Fund. It is because of this fact that a description is given of the early developments of a collection plan by Federal Reserve Banks.

In addition to clearing weekly, Federal Reserve Banks had the privilege of transferring excess balances in the Gold Fund to other Federal Reserve Banks by wire or letter to the Federal Reserve Board. During the week ending June 24, 1915, the Federal Reserve Bank of San Francisco transferred in this way to the Federal Reserve Bank of Boston two hundred thousand dollars. During the week ending July 1, 1915, San Francisco made two transfers, four hundred and fifty thousand dollars to New York and thirty thousand dollars to Chicago. These initial transfers are mentioned because they are historic. After that time, transfers between Federal Reserve Banks became more and more frequent.

The first withdrawal from the Gold Settlement Fund by any Federal Reserve Bank was made on July 14, 1915, by the Federal Reserve Bank of Chicago. Its telegram requesting the payment was received by the Board at 10.30 a.m. and at 2.00 p.m. on the same day the Assistant Treasurer of the United States at Chicago advised the bank of his readiness to make payment. Although in a number of cases thereafter such withdrawals occurred from time to time, the convenience and usefulness of the Gold Settlement Fund became more and more apparent, and there developed a tendency to allow credit balances to accumulate, so that the Fund passed the one hundred million dollar mark on November 18, 1915.

Federal Reserve Agents' Gold Fund

In the latter part of 1915, the Board determined to enlarge the scope of the Gold Settlement Fund by opening accounts with the Federal Reserve agents of the various Federal Reserve Banks. While very little discounting was done by Federal Reserve Banks in the early days of the System, the volume of Federal Reserve notes put out was very considerable. Therefore, almost from the beginning, each Federal Reserve agent had the custody of and the responsibility for a considerable amount of gold, all of which, except 5 per cent deposited with the Treasurer of the United States as redemption fund, remained in his possession. Transactions involved in the issue and retirement of Federal Reserve notes necessitated frequent payments in large sums from the bank to the agent and from the agent to the bank. When these payments were made in gold or gold certificates, much counting and recounting was necessary on the part of the employes of the bank and the representatives of the Federal Reserve agents.

In the early part of September, 1915, the Federal Reserve Board resolved that a Gold Fund should be established for the use and benefit of Federal Reserve agents, not identical with, but in close relation to and coöperation with the Gold Settlement Fund of the twelve Federal Reserve Banks. The settling agent of the Board was directed to open and maintain on the books a distinct and separate account for each Federal Reserve agent and to receive from the said agent, or from the Federal Reserve Bank for the account of such agent, deposits of gold certificates, subject to the order of the Federal Reserve agent for whom such deposits had been made. The fund of the Federal Reserve agents was handled and operated in the same manner as the Gold Settlement Fund of the banks, but, as before mentioned, the funds were handled separately. As a consequence, when transfers were made from an agent to a bank or a bank to an agent, it was necessary for the representative of the Board to make an actual shift of gold or gold certificates from one safe to another or from one compartment in the safe to another compartment.

The Federal Reserve Bank of Atlanta was the first to make such a transfer. On September 8, 1915, $2,-500,000 was passed from the account of the bank in the Gold Settlement Fund to the credit of the Federal Reserve agent. Simultaneously, the Federal Reserve agent of Atlanta released to the Federal Reserve Bank of Altanta the same amount in gold or gold certificates. The second bank to make use of this facility was the Federal Reserve Bank of Richmond, the amount of the transfer being $2,-600,000 from the account of the bank to the account of the agent. At the

time of this writing, the Federal Reserve agents in five of the Federal Reserve Banks are keeping all of the gold deposited with them (except the 5 per cent redemption fund deposited with the Treasurer of the United States) in this fund. Of the remaining seven, six have much larger amounts to their credit in the fund than they are holding in the vaults of their banks. The amount to the credit of all Federal Reserve agents in the fund is $1,169,210,000, while the total amount of gold and gold certificates held by the several Federal Reserve agents at their respective banks is $450,162,000. The total amount in the funds of the Federal Reserve agents and Federal Reserve Banks is $1,665,321,000.

Scope of Clearing Plan

The voluntary intra-district clearing plan, established by nearly all of the Federal Reserve Banks in June, 1915, did not prove successful because it embraced only a comparatively small percentage of member banks whose operations through the Federal Reserve Banks were confined to the exchange of checks upon one another. As a matter of fact, the plan was devised and operated partly as an experiment to develop experience and data necessary to the intelligent planning of a more comprehensive system. The Federal Reserve Board and the officers of all the Federal Reserve Banks had given a great deal of time and study to the situation, both in conferences with the Board and otherwise. On July 15, 1916, the present clearing plan between Federal Reserve Banks and their members and between the Federal Reserve Banks themselves was put in operation. The plan is now too well known to need description. The plan has been modified and improved to some extent since its inauguration. At the time the plan was inaugurated, the total number of member and non-member banks embraced in its operation was approximately fifteen thousand. At the present time the number is 28,191, or 92.8 per cent of all banks in the country, embracing more then 98 per cent of all banking resources. The number of items handled by the System in 1920 was 503,728,000, amounting to $179,459,351,000.

The operation of the new collection plan very greatly increased the number of transactions between Federal Reserve Banks. At the same time, the increasing issues of Federal Reserve notes made necessary an increasing number of transfers between each bank and its Federal Reserve agent and between the banks themselves and the Treasurer of the United States in transactions relating to the 5 per cent redemption fund for Federal Reserve notes.

In its Second Annual Report covering the operations of the Fund, the Federal Reserve Board, page 79, stated: "The Federal Reserve Board has, up to the close of the year 1915, settled through the Gold Settlement Fund for the twelve Federal Reserve Banks indebtedness aggregating $1,-052,649,000 with a net change of only $95,697,000 in ownership of gold held in the Fund, or 8.14 per cent of the total amount cleared. The direct expense incident to the Gold Settlement Fund in handling these transactions has been approximately $1,150, principally for equipment and telegraph services."

In its Third Annual Report covering the year 1916, the Federal Reserve Board stated that the total clearings for the year had been $5,533,966,000. The cost of handling the Fund was $1,343.37, or $0.002½ per $1,000. The net amount of change of ownership among Federal Reserve Banks as

a result of these clearings was only $223,870,000. The Board remarked, "It may be estimated conservatively that the shipment of coin and currency of at least that amount was thus avoided." This statement merits careful attention.

AMENDMENT OF JUNE 21, 1917

The next step in the evolution of the Gold Fund was as follows: It will be remembered that the Gold Funds of the Federal Reserve Banks and the Federal Reserve agents were kept separately and that this arrangement made it necessary for the two representatives of the Federal Reserve Board and the representative of the Treasury Department to open the safe in which the Fund was held in ten thousand dollar gold order certificates and make actual transfers of such certificates from one fund to the other whenever transfers were rendered necessary. Continued increases in the issue of Federal Reserve notes and in the number and amounts of transactions between Federal Reserve Banks, involving large increases in both gold funds and a greatly enlarged number of transactions, made the duties of the custodians of the Gold Fund very burdensome. Therefore, the Board recommended to Congress an amendment to the Act, which became a law on June 21, 1917, for the purpose of simplifying the operation of the Fund, which had grown from $18,450,000 in May, 1915, to considerably more than $500,000,000.

Under the new plan, made possible by the amendment of Section 16 of the Federal Reserve Act, the Treasurer of the United States opened an account with the Federal Reserve Board, giving credit to the Board for the sum of deposits of Federal Reserve Banks and Federal Reserve agents combined. Individual accounts were kept as formerly by the Federal Reserve Board. The Fund was transferred to the keeping of the Treasurer of the United States, and the Board, in its bulletin for July, 1917, in describing the transfer, said: "Some idea of the magnitude of the Fund may be had from the fact that a truck load of gold order certificates (in ten thousand dollar denomination) was transferred from the Federal Reserve Board to the Treasurer of the United States. It took three men over two days to place a stamped endorsement on the certificates. Had the amount represented been in the form of gold coin, it would have weighed 963 short tons. The Treasury of the United States, of course, issued its receipt to the Board for the money."

In its Fourth Annual Report covering the year 1917, the Federal Reserve Board stated that the operation of the Fund, which was, in effect, a clearing house for the twelve Federal Reserve Banks, had been particularly useful during the year by reason of the continuous transfers of very large amounts, which had grown out of the sale of government bonds and Treasury certificates and redistribution and disbursement of the funds realized. The total volume of clearings and transfers through the Fund during the year amounted to $26,962,000,000, as compared with $5,575,000,000 during 1916. The net balances representing the change of ownership between the Federal Reserve Banks of gold held in the fund were $272,000,000. The Board stated: "Without such an arrangement, actual settlings between Federal Reserve Banks would have been accompanied with great expense and loss of time, but by its aid these enormous transfers have been made automatic and instantaneous and have been made without the inconvenience and expense which would have been

unavoidable had a physical transfer and shipment of money been necessary."

It is not only the expense and delay of the physical transfer and shipment of money which was avoided. It is to be doubted whether such transfers would have been possible at all under the old banking plan without creating financial disturbances which would have unsettled the business of the nation.

Up to this time Federal Reserve Banks were still making weekly settlements on a basis of figures shown by their books at the close of business Wednesday. Practically all communications between the Federal Reserve Banks and the Federal Reserve Board with reference to weekly settlements and transfers had been made by wire, and messages had necessarily been sent over the commercial wires. The necessity for private wires between all Federal Reserve Banks and branches and the Federal Reserve Board became too urgent to be postponed. A private or leased wire system was put in operation on June 4, 1918, and all Federal Reserve Banks employed telegraph operators.

DAILY SETTLEMENTS THROUGH THE GOLD FUND

The next step in the evolution of the Gold Fund was the institution of daily instead of weekly settlements. On July 1, 1918, a daily settlement plan was put into effect. In the *Bulletin* for July, 1918, the Board said:

> The plan will eliminate a great deal of work at the Federal Reserve Banks, and through daily instead of weekly settlements will provide for the proper adjustment of the gold holdings to the credit of each Federal Reserve Bank in the Gold Settlement Fund in as nearly automatic a way as possible. At the present time, the Federal Reserve Banks, in addition to the weekly settlement, have the privilege of demanding transfers at any time upon the net debit balance as shown in accounts with other Federal Reserve Banks. It must be expected that if the present plan of weekly settlement were to be maintained, such transfers would become more numerous in the future as the calls upon the Federal Reserve Banks became heavier. The proposed plan (for daily settlement) would do away with the greater part of such transfers and will release for the strengthening of their reserves the funds now carried as the amounts due from other Federal Reserve Banks. Under the law, balances due from other Federal Reserve Banks could not be counted as a part of the reserve of any Federal Reserve Bank, but under the regulations of the Board, which then existed, such balances due from other Federal Reserve Banks were allowed as deductions from net deposits in making reserve calculations.

GROWTH IN CLEARING TRANSACTIONS

Combined clearings and transfers through the Fund during the year 1918 aggregated $50,242,000,000. Thus, by gradual development, what seemed, and was indeed, a formidable undertaking was worked out. The internal accounting operations of the Federal Reserve Banks were readjusted and improved, but no change was made in the plan of settlement during the year 1919. Clearings and transfers through the Fund for the year 1919 aggregated practically 74 billion dollars. The Board, in its annual report for the year 1919, made the following statement:

> When it is considered that these enormous transfers are made almost instantaneously by means of the leased wire system without involving the physical movement of a dollar, it will be seen that the arrangement has been of incalculable value to the government, the banks and the public. The total expense of operation, including the cost of the leased wires and the salaries of accountants, was approxi-

mately $250,000. This represents the basic cost of effecting domestic exchanges between the several reserve districts. A charge of ten cents per one hundred dollars, if generally imposed, would have imposed an expense on the commerce of the country of $73,984,252.

The leased wire system had been extended to all branches of Federal Reserve Banks, and in many cases these branches participated in the Gold Settlement Fund.

The last refinement in the evolution of the Gold Settlement Fund was made when all transactions between Federal Reserve Banks which are settled through the Gold Fund were made effective on the day on which they occurred. This was made possible by the introduction of a plan or practice under which all transactions to be settled through the Gold Fund were wired to the Board from the banks and the branches, and the Board made the settlement upon its books as of that day at the earliest possible hour on the following morning, and wired the settlement figures to each Federal Reserve Bank. The Federal Reserve Banks kept their books open until such wires were received from the Federal Reserve Board, and then made the few entries necessary and closed their books as of the previous day. This plan has worked admirably and has eliminated all the float which had to be carried by those Reserve Banks with credit balances in the settlement under the previous plan, by which the daily settlement payments were not received until the day following that on which the settlement figures were made up. The volume of clearing through the Gold Fund for the year 1920 was $92,625,000,000. The average weekly volume of clearings increased from $31,898,000 in 1915 to $1,793,584,000 in 1920.

"Behold, how great a matter a little fire kindleth!" Thus, from cautious beginnings, feeling the way, but nevertheless with unexpected rapidity of progress, the Federal Reserve System has developed the most effective, the most comprehensive and the most economically administered exchange system in the world of banking. When all the banks of the country are on a par clearing basis, the system can be made still more effective and useful.

At the present time, a member bank may obtain from its own Federal Reserve Bank, free of expense to itself, a telegraphic transfer of funds, in any amount, to any point in the country where a member bank is located. These transactions are effected between Federal Reserve Banks and are settled through the Gold Fund.

The Gold Fund has been of inestimable value to the Treasury, and has rendered easy of accomplishment the most stupendous financial operations ever undertaken. During the past two years, the government has collected taxes from every nook and corner of the country, amounting to about one billion dollars quarterly. Certificates of indebtedness have been issued, have matured and been paid, and the receipts and disbursements of the Treasury for a single day, on occasions, have amounted to approximately a billion dollars each way. All of these funds passed through the Federal Reserve Banks; they were adjusted and redistributed through the Gold Fund without disturbance of the financial equilibrium and so smoothly as to occasion hardly a comment. It has become a routine matter.

Lord Byron makes the Prisoner of Chillon say:

> "So much a long communion tends
> To make us what we are."

So we say that the public from long communion with these huge transactions now takes them as a matter of course, but without fully understanding that it is the wonderful working of the Federal Reserve System which makes us commercially and financially what we are.

Eligibility for Discount

By CHARLES L. POWELL
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THE kind and character of paper which the Federal Reserve Banks may discount for member banks is in broad general terms defined in Section 13 of the Federal Reserve Act. It is there provided that the Federal Reserve Banks, upon the endorsement of member banks, may discount for them: (1) notes, drafts and bills of exchange issued or drawn for agricultural, industrial or commercial purposes, or the proceeds of which have been used or are to be used for such purposes; (2) acceptances of banks of the character and kind described in the Act.

The Federal Reserve Board, by the same section of the Act, is given the right to determine or define the character of paper made eligible for discount within the meaning of the Act; and, the Board in the exercise of this statutory right has, from time to time, promulgated a series of regulations for the guidance of the Federal Reserve Banks and member banks. These regulations, while not a part of the statute, having been made and promulgated by a lawfully constituted body, have the force and effect of law.[1] As is said by the Supreme Court of the United States, in *United States* v. *Clark*, "the Legislature cannot delegate its powers to make a law, but it can make a law to delegate a power to determine some fact or state of things, upon which the law makes, or intends to make, its own action depend." Accordingly, the regulations made by the Federal Reserve Board defining, applying and limiting the character of paper eligible for rediscount must be read as part of the Act.

GENERAL LIMITATIONS ON ELIGIBILITY

The limitations on eligibility for discount, as provided by the Act and the regulations of the Board, are directed to (1) the maturity of the paper and (2) its source of origin, or the purposes for which it is to be used. The language used by the Act in respect to the latter is modeled upon many prior proposals for legislation and was manifestly for the purpose of avoiding the use of bank funds in two general classes of transactions, that is to say, in speculative transactions and in transactions involving capital investments.

The reason for these two provisions of the Act—the one relating to the origin or purpose of the note or bill and the other to its short maturity—is found in the recognized necessity of keeping the assets of the bank liquid at all times and thus readily available to meet the demands of commerce and trade.

It was expected, and the operation of the Act has proved it to be the case, that a large part of the banking resources of the nation would find its way into the

[1] *United States* v. *Grimaud*, 220 U. S. 506; Dasterbignes Case, 122 Fed. 30; *United States* v. *Clark*, 143 U. S. 664.